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C O N F I D E N T I A L SECTION 01 OF 05 BAKU 000481

SIPDIS

E.O. 12958: DECL: 06/15/2019
TAGS: PGOV PREL AJ TU ENRG
SUBJECT: AZERBAIJAN: PRESIDENT ALIYEV TALKS EURASIAN ENERGY WITH SPECIAL ENVOY MORNINGSTAR

Classified By: Ambassador Anne E. Derse, Reasons 1.4 (b,d)

¶1. (C) SUMMARY. President Aliyev told Special Envoy Morningstar that lack of transit through Turkey for Azerbaijani gas destined for European markets was the biggest obstacle facing a "Southern Corridor" for Caspian gas westwards. The European Union should recognize that Nabucco, although perhaps not commercially viable, is strategically important enough for European energy security for it to subsidize its construction. Similarly, the EU should move quickly to work with Turkmenistan on getting Turkmen gas going west. Unfortunately, the reality is that the EU is divided and ineffective in energy security and Central Asia is unwilling to commit volumes westwards in the face of active Russian opposition. The only positive aspects in favor of the Southern Corridor were the USG's and GOAJ's shared strategic vision and unanimity of purpose. Aliyev suggested that greater Euro-Atlantic coordination, plus increased pressure on Turkey, would be the only way for the vision of the Southern Corridor to become a reality. END SUMMARY.

¶2. (C) On June 1 Special Envoy (SE) for Eurasian Energy Ambassador Richard Morningstar and Ambassador Derse met with President Ilham Aliyev. Also present were Deputy Assistant Secretary Matt Bryza, SE Senior Advisor Daniel Stein, and notetaker.

¶3. (C) President Aliyev welcomed SE Morningstar back to Baku and to Caspian energy issues. USG support for Southern Corridor (SC) projects was vital. SE Morningstar said the USG realized the region's importance, that Eurasian energy issues had the "highest level" attention back in Washington, and that he was committed to working with Azerbaijan and President Aliyev. He would also "push for a solution" with Turkey on GOAJ-GOT gas transit and pricing issues, such a solution being critical for the Southern Corridor.

TURKEY
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¶4. (C) Aliyev said the regional energy situation was "broader and more complicated" since Morningstar last worked the issues in the 1990s. Azerbaijan and the US have "lost a lot of time" due to the negative developments in bilateral GOAJ-GOT relations. Azerbaijan didn't push when Turkey caused unjustified delays in the Southern Corridor, so as not to damage overall bilateral relations. But Turkey's recent move to open its border with Armenia so damaged thee relations that Baku felt free to raise these peviously subordinated concerns.

¶5. (C) Aliyev aid Turkey is offering to buy Azerbaijani Shah

Dniz Phase One (SD1) gas, which it is already receiing, at a price that is little more than half th price it is paying for Russian gas (USD 240 per thousand cubic meters based on an oil price of USD 93 per barrel), and is asking for such a high a volume of Shah Deniz Phase Two (SD2) gas (eight bcm/a, available 2012-2013 timeframe) that not insufficient volumes would be left over to sanction a pipeline to Europe. Aliyev said Turkey insists that Azerbaijan sell it deeply discounted gas at the same time it makes SOCAR pay market price for the gas it buys as feedstock for its own uses (at a chemical complex) within Turkey.

¶6. (C) The President said there has been some recent progress with Turkey re SD1 pricing and SD2 transit, but "nothing has been resolved," and Turkey is "ruining the efforts I have made since 1994" on behalf of the Southern Corridor. If Ankara continues its current positions, "it would get zero volumes from this part of the world." He said there has been no real progress on gas transit to European markets through Turkey because the GOT is seeking to link transit to gas pricing and volume issues. The price Turkey pays for Azerbaijani gas must be market-based, at volumes that won't undermine the Nabucco project, and Turkey must grant transit to upstream gas based on international transit standards.

¶7. (C) SE Morningstar said he hoped the new GOT Energy Minister Taner Yildiz and GOT Prime Minister (PM) Erdogan would be more 'strategic' in their thinking. The longer the delay in transit, the later SD2 sanctioning would be and the later first gas would be available. It was unclear why there has been no agreement on volumes to be sold to Turkey.



Turkey could be sold four bcm/a from SD2, with a clause for additional sales in the case of an emergency, especially as there could be gas available from ACG non-associated gas (aka 'Deep Gas' from the main offshore oil field) and/or from Turkmenistan.

¶8. (C) Aliyev added that future volumes could also come from Azerbaijan's 'Absheron' offshore field to be developed by Total, and the 'Umid' offshore gas field that SOCAR was seeking to develop. Turkey should realize that four bcm/a is better than none. Turkey assumes that Azerbaijan is "landlocked and has no other options," but Azerbaijan does have other options, and is not in urgent need of either developing or selling its gas. Developing SD2 will cost approximately USD 20 billion, and neither Azerbaijan nor the Shah Deniz Consortium (SDC) will go ahead with this huge investment if the conditions are not right.

¶9. (C) Aliyev said that Azerbaijan wanted to sell some SD2 gas to Turkey, and could probably sell as much as eight bcm/a - anything more and Nabucco becomes 'problematic.' Azerbaijan doesn't want to sell all its gas to Turkey, since Turkey would then seek to stick it to Azerbaijan on the price. Aliyev laughed, saying that when Turkey asks Azerbaijan why it insists on selling gas to Europe and not its "Turkic brothers," he can't respond honestly that it is because he doesn't trust Turkey.

¶10. (C) Morningstar said he would be seeing GOT Energy Minister Yildiz later in the week, and asked Aliyev what he should tell him. Aliyev said Morningstar should counsel Yildiz to "agree to the SOCAR proposal," which is a fair one. Turkey's proffered gas price of USD 240 for SD1 (assuming a barrel of oil at USD 93 per barrel) is too low. Azerbaijan is willing to agree on a lower price for the gas it sells to Turkey, but not forty to fifty percent lower than the price Russia gets from Turkey for its gas. Turkey's desire for cheap gas won't be at Azerbaijan's expense.

¶11. (C) Aliyev said Azerbaijan cannot act unilaterally on either SD1 or SD2, as the Shah Deniz Consortium (SDC), a commercial a commercial entity comprised of SOCAR and various international energy companies (IOCs), must make these

decisions. For example, StatoilHydro and the Azerbaijan Gas Supply Company (AGSC) that markets SD1 gas must decide on the payment schedule for the GOT in relation to SD1 (NOTE: the Consortium and Turkey's Botas are negotiating the new price of SD1 gas, which will apply retroactively back to April 15, 2008).

¶12. (C) SE Morningstar said that Turkey doubtless wanted to use the low price it hoped to get from Azerbaijan as a benchmark to lower the price of Russian gas. Aliyev said Russia has too much leverage on Turkey for this to happen, as Turkish efforts to gasify its country have made it more dependent on gas, and thus more dependent on Russia. Russia can afford to reduce or stop gas sales to Turkey, but Turkey needs Russian gas, as sixty-five percent of all Turkish gas imports are from Russia. Morningstar said he would try to convince Turkey to think strategically and to seek to lessen its dependence on Russian gas. He pointed out to Aliyev that he has dealt with Turkey for many years, and that Turkey always "winds up wasting two years, eventually taking the same deal that it refused two years earlier." Aliyev said that "Turkey must make a choice now," and pointed out that their actions have already lost them the influence in Central Asia they'd been seeking.

¶13. (C) DAS Bryza asked if President Aliyev were concerned about Blue Stream Two (BS2), given both Turkish-Russian closeness and the "spooky" relationship between Putin and Berlusconi. Morningstar commented that if BS2 brought gas to Turkey, it might help the chances of SD2 transit to European markets. Aliyev said he wasn't unduly concerned since developing its gas was "important but not urgent" for Azerbaijan. With Southstream and BS2, Russia was seeking to bypass Ukraine, which will weaken Ukraine. It wasn't clear why Italy was helping Russia in this regard, but the matter was out of Azerbaijan's hands. Hungary, Greece, Italy and Bulgaria have all been two-faced in their support for Azerbaijan on the one hand and South Stream and Russia on the other.

UKRAINE



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¶14. (C) Morningstar agreed with Aliyev's Ukraine comments, saying that Ukraine kept making the same mistakes repeatedly, and that perhaps North Stream might not be all bad to the extent it put pressure on Ukraine to act seriously. Aliyev said that many so-called 'independent' countries, to include Armenia, who obeyed Russian dictates on Kosovo and NATO training, are under Russia's sway, and the same could happen to Ukraine. Ukrainian politics were very pro-Russian these days, with only Yushchenko trying to do something positive, but he had no public support. If there were de-facto Ukraine 're-unification' with Russia, it would influence other FSU countries.

EU
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¶15. (C) Aliyev said Italy was not acting like an EU leader, but instead contrary to EU's interests. Its support of doubling South Stream to 60 bcma "sent the wrong signal to all of us," and risked making the Southern Corridor "just an idea." Unfortunately, there is no European unity and no NATO unity on energy issues. SE Morningstar added that it was not just Italy, but also Germany who was not acting as a European leader. Aliyev agreed, decrying the current occupation of former German Chancellor Schroeder.

¶16. (C) Morningstar asked Aliyev if he thought Southstream was commercially viable, as its putative USD 11 billion cost was in fact probably closer to 20 billion, a price tag that was causing Italy serious discomfort. Aliyev pointed out in essence Southstream was a 'political,' vice 'commercial'

pipeline, and as such Russia could build it if it wished. They have the money, especially now that oil prices are coming back up. Even if Italy backed out of the project, Russia would build Southstream.

¶17. (C) Aliyev said Russia's goal was to monopolize the European gas market, and wants to buy Azerbaijani gas it doesn't need merely to stop the Southern Corridor. "When Europe starts freezing again," it will be at Russia's mercy. Russia was actively opposing the Southern Corridor project, Central Asia was currently unwilling to commit resources to it, the EU was talking out of both sides of its mouth about it, and "there could always be another surprise in Georgia." Aliyev concluded that the only two positive elements of the Southern Corridor project were GOAJ and USG support.

TURKMENISTAN
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¶18. (C) Morningstar said he'd just had "interesting meetings" in Ashgabat, where the IOCs want access to the Turkmen onshore and Berdimuhamedov is upset with Russia. But Berdimuhamedov wants Production Sharing Agreements (PSAs) only offshore; onshore he wants "Service Agreements." IOCs believe that if they can build onshore production, increased supplies will create new commercial possibilities to send gas west, which would, inter alia, obviate the need for united EU action re Turkmenistan.

¶19. (C) Aliyev said IOCs participating in Turkmen onshore gas development would be good, but he didn't know if it was doable. The Turkmen were 'clueless' about hydrocarbon development, had a small population, and already had pipelines to Russia and China (and Iran). If it sold at half its current levels it would still be able to meet its needs, and as such doesn't need to increase gas production. It was up to potential consumers to "pull" increased production from the GOTX. When Aliyev, GOT President Gul and Berdimuhamedov had their recent summit, Berdimuhamedov committed to sending 10 bcm/a westwards. Technically getting GOTX west would be easy; the political aspects will be hard. The EU's Caspian Development Corporation (CDC) could help in this regard by subsidizing a trans-Caspian pipeline.

¶20. (C) Aliyev said that bilateral relations with Ashgabat were now 'normal.' On delimitation, the GOAJ position is to offer joint ownership and development of the disputed Serdar-Kyapaz (S-K) offshore field, with the GOTX having a majority share. SOCAR could be the operator, but that wasn't a deal-breaker. Production from the field would have to be



sent west. The GOTX offer is that SOCAR can be in charge of S-K development, but ownership is 100 percent GOTX, which is unacceptable to Azerbaijan. If Berdimuhamedov agrees to the GOAJ proposal, the two countries can 'draw a line' and four of the five Caspian littoral countries would be in agreement, leaving Iran in isolation. Exactly where the delimitation line is drawn is not important. Aliyev concluded by saying that SOCAR President Abdullayev had recently restated this offer to Berdimuhamedov, and Azerbaijan was still waiting for an answer.

BUILD NABUCCO NOW
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¶21. (C) Morningstar asked if perhaps an incremental approach to Southern Corridor development might not be the way forward. After Azerbaijan and Turkey settled outstanding issues, current and SD2 volumes could be used to provide gas to Europe via the TGI project. Later, with development of more Azerbaijani gas, Iraqi gas and possible Turkmen gas coming westward, there could be enough gas for the Nabucco project.

¶22. (C) Aliyev responded that Nabucco must be a 'political' project, since "commercially it will not work." There was no need to stipulate minimal initial volumes to make Nabucco viable: Europe should sanction Nabucco purely for reasons of its energy security. But "Bulgargas and MOL" (Bulgaria and Hungary) can't do this alone. The EU should commit 'billions,' and the U.S. also has resources it can commit. If Turkey grants transit to upstream gas, small volumes of Azerbaijani non-SD2 gas will get to European markets via the Turkish gas grid, but SD2 gas should go via Nabucco. EU should realize the political necessity of the Nabucco project and "start construction immediately." There needs to be more "visible activity" surrounding Nabucco. Even if there is no Turkmen gas for Nabucco, "even if only two bcm/a fill Nabucco in the beginning," it should be built: costs can be recovered later. Even if Nabucco never turns a profit, Europe will have the increased energy security.

¶23. (C) In a related vein, the CDC should become a tool of Euro-Atlantic cooperation, and the cross-Caspian pipeline should be supported by international financial organizations. There should be immediate negotiations between Azerbaijan and Turkmenistan, and a tender for a feasibility study to start pipeline construction westwards from the Turkmen shore.

RUSSIA
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¶24. (C) Aliyev said SOCAR is "getting calls every day from Gazprom" about buying SD2 gas. In his own meetings with President Medvedev, Aliyev is receiving similar pressure to make a gas deal. SOCAR President Abdullayev has resisted Gazprom President Miller's blandishments heretofore, but if Gazprom offers a market price for SD2 and Turkey remains hostile and Europe indifferent, there is no reason for Azerbaijan to say keep saying no.

¶25. (C) Aliyev said in 2010 Azerbaijan will have surplus gas and nowhere to sell it. If Turkey grants transit, Azerbaijan could supply volumes to Greece and Bulgaria even before SD2 came online. Azerbaijan can also sell these volumes to Russia. One bcm/a is equivalent to approximately USD 200-300 million, and Azerbaijan should monetize this surplus gas. What needs to be remembered is that for Azerbaijan, which sells so much gas westwards to Turkey, diversification is selling north to Russia. SOCAR's recent MOU with Gazprom was an attempt to show Turkey that, as Aliyev has told GOT PM Erdogan, Azerbaijan has other options. Aliyev has told GOT President Gul that Russia wants SD2 for political reasons and Iran wants it for economic ones.

NEXT STEPS
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¶26. (C) DAS Bryza asked President Aliyev if it were more important for the USG to be focused on pressuring Turkey on gas price/transit issues, or on pressuring the EU to act more decisively to secure its energy needs. Aliyev said it was hard to say, but that signing the Nabucco IGA would be a good



first step. After that, there should ideally be a memorandum outlining the joint Euro-Atlantic Energy Policy.

¶27. (C) More generally, when asked what USG next steps should be Aliyev said there should first be a trans-Atlantic discussion on the importance of European energy security. There should be a clarification of positions on both sides of the Atlantic, at least at the Secretary of State/Minister of Foreign Affairs level or above, with each European country, big or small, making its position clear. This should be followed by a common decision for each country not to work against the interests of its EU partner countries. Next, there should be "practical steps" to start pipeline

construction. Morningstar said the USG was trying to create a "Trans-Atlantic Energy Council" to help Europe arrive at such a unity. Part of the USG mission would be to convince Germany and France that it was in their best interest to lessen Russian market dominance.

¶28. (C) Aliyev stressed that throughout there must be 'active communication' with the GOT PM and President. Lack of gas transit through Turkey was the major obstacle barring creation of a Southern Corridor for gas. The GOT should not link transit through Turkey with other issues. Once Turkey agrees to transit, "Shah Deniz Phase Two can be sanctioned." The problem is that there is no "Southern Corridor Champion" in Turkey. The Energy Minister is new, and the Prime Minister doesn't focus on these issues.

¶29. (C) COMMENT: President Aliyev seemed genuinely pleased at SE Morningstar's appointment -- the UK Ambassador later told us that Aliyev had sung Morningstar's praises to Prince Andrew in their recent private dinner, noting how pleased the GOAJ is with his appointment -- , and the atmospherics were warm and positive. Aliyev's contention that if the EU thinks Nabucco is important it should build it, while true by definition, does not seem to be a realistic option. European governments are unlikely to foot the large bill at this time; participation of international energy companies will require a commercially sound plan. As has been the case for the last 18 months, both Aliyev and Morningstar agreed the key to reviving the moribund Southern Corridor project is to get gas transit through Turkey, which has become tied up with pricing and volumes issues for the gas that Turkey expects from Azerbaijan. END COMMENT.

¶30. (U) SE Morningstar has cleared this cable.
DERSE